NOS. 88-2049, 88-2052

Supreme Court, U.S.
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In the
Supreme Court of the United States

OCTOBER TERM 1988

EMPLOYERS INSURANCE OF WAUSAU, ET AL.
Petitioner

versus

AVONDALE SHIPYARDS, INC., ET AL.
Respondents

OCCIDENTAL PETROLEUM CORPORATION, ET AL.
Petitioners

versus

AVONDALE SHIPYARDS, INC., ET AL.
Respondents

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

RESPONDENTS' CONSOLIDATED BRIEF IN OPPOSITION TO PETITIONS FOR CERTIORARI

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QUESTIONS PRESENTED

Petitions No. 88-2049 and 88-2052 present similar questions arising from the same case. These questions are:

A. Whether the court of appeals was correct in determining that the holding of this Court in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986), precludes a maritime tort action against a party which contracted to supervise the construction of a vessel where petitioners suffered only economic losses resulting from the loss of the vessel.

B. Whether the court of appeals was correct in holding that one of the defendants could assert the defense afforded by *East River,* where (1) that defendant had pled as a defense the failure to state a claim upon which relief can be granted, and (2) the *East River* decision was not rendered until after the decision by the trial court.

C. Whether the court of appeals was correct in interpreting, in light of New York law, a complex shipbuilding contract negotiated between two large commercial entities. In particular, petitioners contest the court of appeals' conclusions:

1. That the Guarantee Deficiency Clause of the particular contract incorporated or subsumed an express warranty of seaworthiness;
2. That the contractual limitations of remedies, including the exclusion of consequential damages and repair or replacement remedy, applied under the circumstances;
3. That the limited remedy provided in the contract did not fail in its essential purpose.

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STATEMENT OF THE CASE

Petitioners[1] sued to recover their economic losses resulting from the sinking of an integrated catug-barge ("ITB"), the Oxy Producer, as well as economic losses with respect to the Oxy Producer's two sister ships, the Oxy Trader and Oxy Grower. Petitioners sued those involved in the design and construction of the vessels: Avondale Shipyards, Inc. ("Avondale"), the shipyard which constructed the vessels; Ogden Corporation ("Ogden"), the guarantor and former parent of Avondale; J.J. Henry Company, Inc. ("J. J. Henry"), the naval architectural firm involved in the design of the vessels; Victoria Machine Works, Inc. ("Victoria"), a manufacturer of certain components in the vessels; and various entities affiliated with Hvide Shipping, Inc., including Hvide Shipping, Inc. Hvide Marine International, Inc., Seabulk Transmarine I, Inc., and Seabulk Transmarine II, Inc. (collectively referred to as "Hvide"). Hvide was involved with the vessels in several ways. First, it held the patent for the catug integrated tug-barge design. Second, it participated with J. J. Henry in the design of the Oxy Producer and its sister

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[1] Petitioners in No. 88-2052 include various parties affiliated with Occidental Petroleum Corporation, including Suwannee River Lines, Inc., Suwannee River SPA Lines, Inc., Suwannee River Phosphate Lines, Inc., the bareboat charterers of the three Oxy ships, Suwannee River Chartering, Inc., the time charterer of the ships; Occidental Export, Inc., the seller of certain chemicals transported by the ship; Occidental Chemical Agricultural Products, Inc.; and Occidental Petroleum Corp., the parent corporation of all the preceding parties. Also included among the petitioners in No. 88-2052 are the London underwriters subscribing to Certificates No. 14880, 14882, and 14888. Petitioners in No. 88-2049 inculde the American underwriters subscribing to Certificate of Insurance No. 14880.

ships. Third, Hvide was retained by Occidental to supervise the construction of the vessels. Finally, Hvide was charged with manning and operating the Oxy Producer and its sister ships.

After rejecting a conventionally designed vessel, Occidental decided to construct three identical ITB's principally because they were less expensive to operate with their lower manning requirements. After extensive negotiations, Avondale and Occidental executed a lengthy, complex construction contract ("the Contract") for each of the vessels. In the Contracts, Avondale agreed to construct the Oxy Producer and its sister ships in accordance with the Vessel Plans and Specifications. However, the parties also expressly limited the remedies available in the event that the vessels were not completed in accordance with the plans and specifications. Among the limitations were: (1) an exclusion of warranties other than certain designated warranties in the Contract; (2) a limitation of remedy to repair or replacement of deficiencies known as guarantee deficiencies; (3) a separate exclusion of the consequential damages, including damage to the vessel itself; and (4) an express exclusion of all other remedies, whether in contract or tort.

Both the tug and the barge of the Oxy Producer were constructed by Avondale under Hvide's supervision. After successful sea trials, Occidential accepted the Oxy Producer. Thereafter, the Oxy Producer made one successful round trip to the Soviet Union. On its second voyage, however, the vessel encountered extremely rough weather during which the system connecting the tug and the barge was damaged. The captain diverted the vessel to Porta Delgado in the Azores. The Oxy Producer spent several days anchored outside Porta Delgado where repairs to the interconnection system were started. On September 20,

1981, the partially repaired vessel got under way in an attempt to ride out impending storms. Unfortunately, on the same morning, the tug portion of the Oxy Producer sank.

The trial was bifurcated and a bench trial on the issue of liability was held. The trial court found that the cause of the sinking of the Oxy Producer was the improper mating of the tug and barge upon delivery[2] and held that both Avondale and Hvide were liable for the sinking of the tug -- Avondale under its shipbuilding contract, and Hvide under both its supervision contract and under a theory of maritime tort.

The Court of Appeals for the Fifth Circuit affirmed the findings of liability, but modified the trial court's conclusions in several important respects. With respect to Avondale and Ogden, the court of appeals held that plaintiffs' recovery was limited to remedies provided in the Contract. With respect to Hvide, the court of appeals concluded that this Court's decision in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986), precluded imposing maritime tort liability.

The trial court dismissed all claims against defendants Victoria and J. J. Henry. On appeal, the Court of Appeals for the Fifth Circuit affirmed the trial court's conclusion that neither Victoria nor J. J. Henry was responsible for the sinking of the Oxy Producer, but the court of appeals reversed the trial court to the extent that it had dismissed all claims against these defendants. The court of

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[2] Avondale vigorously disagrees with the findings of the trial court and the court of appeals that the cause of the vessel's sinking was due to improper mating upon delivery. However, Avondale does not seek to have this Court review these findings.

appeals concluded that J. J. Henry and Victoria were still potentially liable for the unresolved claims involving the sister ships. The court of appeals' holdings with respect to J. J. Henry and Victoria are not at issue before this Court.

ARGUMENT

I. *THE QUESTIONS PRESENTED DO NOT MERIT REVIEW.*

None of the questions presented by petitioners, especially those relating to respondents Avondale and Ogden, merit this Court's review. The questions relating to Avondale and Ogden relate solely to petitioners' challenges to the court of appeals' interpretation of a lengthy, complex shipbuilding contract negotiated between two large commercial entities. These questions involve no issues of constitutional law, no issues of federal statutory law, or federal maritime law. Neither group of petitioners cites any decision of this Court in their arguments involving Avondale and Ogden. The issues relating to Avondale and Ogden involve only the interpretation of the particular wording of the Contract in light of New York law. The court of appeals was correct in its interpretation of the Contract and its decision is consistent with those of the New York courts. However, regardless of whether the court of appeals was correct on the state law issues, there are no overriding policy concerns in the present case that warrant this Court's review. The case has little implication beyond the determination of the rights and liabilities of the parties.

Petitioners do not articulate any "special and important reasons" to support their argument that this Court should exercise its discretionary power of review. Rule 17 of the Supreme Court of the United States provides that a

review on the writ of certiorari is a matter of judicial discretion and will only be granted "when there are special and important reasons therefor." Respondents recognize that Rule 17 does not fully measure or limit this Court's discretion. However, Rule 17 implies that there must be a substantial federal question presented to warrant the granting of certiorari. The court of appeals' decision is not in conflict with a decision of another federal court of appeals, nor has the court of appeals decided a federal question in a way which conflicts with a state court of last resort. There is also no evidence that the court of appeals has "so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court" as to warrant an exercise of this Court's power of supervision.

Certiorari should not be granted "except in cases involving principles the settlement of which is of importance to the public, as distinguished from that of the parties," and where "there is a real and embarrassing conflict of opinion and authority between the Circuit Courts of Appeals." *Rice v. Sioux City Memorial Park Cemetery,* 349 U.S. 70, 79 (1955) (quoting *Layne & Bowler Corp. v. Western Well Works, Inc.,* 261 U.S. 378, 393 (1923)). No such reasons exist in this case. Petitioners are merely dissatisfied with the results below as it effects them as litigants. This Court has stressed that it does not "sit for the benefit of the particular litigants." *Rice,* 349 U.S. at 74.

II. *THE COURT OF APPEALS CORRECTLY DETERMINED THAT EXPRESS WARRANTIES WERE INCLUDED OR "SUBSUMED" WITHIN THE DEFINITION OF GUARANTEE DEFICIENCY CONTAINED IN THE CONTRACT.*

In addition to setting forth Avondale's responsibili—

ty with respect to constructing the Oxy Producer, the Contract contained a number of carefully negotiated provisions that limited the warranties and remedies available to the purchaser, Occidental. The Contract defined "guarantee deficiency" in Article I(a):

> *Guarantee Deficiency.* "Guarantee Deficiency" shall mean any weakness, deficiency, failure, breaking down or deterioration in workmanship or material produced or furnished by the Contractor in performing the Contract Work or any failure of any equipment, machinery or materials produced or furnished by the Contractor or a vendor or subcontractor of the Contractor to function as prescribed in the Vessel Plans and Specifications.

The term "contract work" referred to in the definition of "guarantee deficiency" is defined in Article I(i):

> *Contract Work.* "Contract Work" shall mean all work required to be performed by the Contractor under the Vessel Plans and Specifications in this Construction Contract.

The definition of "guarantee deficiency," particularly with its reference to "contract work," is broadly defined so as to include *any deficiencies* by Avondale in meeting the requirements of the Contract and/or the Vessel Plans and Specifications. Thus, if, as the courts below found, the Vessel Plans and Specifications called for the vessel to be mated in a particular fashion, failure to mate the vessel in such a fashion would come within the definition of "guarantee deficiency." Similarly, if the Vessel Plans and Specifications called for the vessel to be "seaworthy," any failure of the vessel to be "seaworthy," would come within the definition of "guarantee deficiency." In effect, the definition of "guarantee deficiency" is so broadly defined that it incorporates all express representations and war-

ranties made throughout the Contract and the Vessel Plans and Specifications.

After broadly defining the concept of "guarantee deficiency," the Contract in Article XVIII(g) provides:

> THE WARRANTIES AND GUARANTEES SET FORTH IN ARTICLE VIII, RELATING TO SPEED, FUEL CONSUMPTION, SPA CARRYING CAPACITY AND DEADWEIGHT TONNAGE, IN THIS ARTICLE XVIII, RELATING TO ANY GUARANTEE DEFICIENCY AND IN ARTICLE XXXVIII RELATING TO DESIGN RESPONSIBILITY FOR THE BARGE, ARE EXCLUSIVE AND ARE IN LIEU OF ALL IMPLIED WARRANTIES (INCLUDING BUT NOT LIMITED TO IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE AND WORKMANLIKE SERVICES).

This provision has two important ramifications. First, it excludes all implied warranties. Second, it provides that the guarantees and warranties set forth in the three designated articles are the exclusive warranties of the Contract. However, because the term "guarantee deficiency" was broadly defined to incorporate any deficiencies with respect to any express representations made elsewhere in the Contract or in the Vessel Plans and Specifications, Article XVIII(g) does not actually have the effect of excluding express warranties made elsewhere in the Contract. Rather, the effect of this provision is to incorporate or "subsume" within the term "guarantee deficiency" all express warranties or representations made elsewhere in the Contract. What this provision makes clear is exactly what the court of appeals found: If the Contract or Vessel Plans and Specifications imposes a requirement on Avondale, the breach of that obligation must be treated as a guarantee

deficiency, and should not be considered as a totally independent warranty operating free of the other provisions of the Contract. *See* Appendix A at 70a-74a.[3]

After defining "guarantee deficiency," the Contract provides the remedies available in situations where guarantee deficiencies occur. Article XVIII(a) of the Contract provides in part:

> [T]he Contractor shall not be responsible for the cost of correcting any such Guarantee Deficiency to the extent that such Guarantee Deficiency resulted from the Purchaser's specific written direction later found to result in a Guarantee Deficiency . . ., *nor to the extent that it is due to ordinary wear and tear, nor to the extent increased by the negligence or other improper act of the Purchaser or any operator of the Vessel or of any other person than the Contractor or its subcontractors during the Guarantee Period. The liability of the Contractor to the Purchaser under this Construction Contract on account of any such Guarantee Deficiency shall not extend beyond the actual corrective repair or replacement thereof* at customary commercial shipyard or ship repair yard rates including the costs of dockage of the Vessel, if necessary. *The Contractor shall not be liable to the Purchaser for any damage to the Vessel or its equipment or cargo or the property of such Purchaser or for consequential damages of the Purchaser arising out of any Guarantee Deficiency,* except that in the event of any Guarantee

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[3] Petitioners in No. 2049 and Petitioners in No. 2052 filed identical appendices with the same pagination. The Opinion of the court of appeals is reproduced in both appendices at 1a. Citations to this Opinion are in the form "Appendix A at ____."

> Deficiency in any item of machinery or equipment furnished by the Contractor, the Contractor shall be liable not only for the cost of correcting or repairing such Guarantee Deficiency, but also shall be liable for the cost of correcting or repairing the damage to the item of machinery or equipment on the vessel caused by such Guarantee Deficiency.

(Emphasis added).

Article XVIII(a) limits Occidental's remedies in several important respects. First, the provision provides that Avondale is only responsible for the actual corrective repair or replacement of the guarantee deficiency, or the cost of such repairs. Second, the provision provides that Avondale will not be responsible to the extent that any damage to the vessel is increased by the negligence or improper act of any person other than Avondale or its subcontractors. Third, the provision contains an independent exclusion of consequential damages, including "any damage to the Vessel or its equipment or the cargo or the property of such Purchaser."

After carefully limiting the contractual remedies, the Contract in Article XXXVI provides that the remedies set forth in the Contract are exclusive:

> Notwithstanding any other provision of this Construction Contract, the rights and remedies as expressed herein shall be exclusive and in lieu of any other remedies available to Purchaser and to Contractor, whether in contract, tort or otherwise.

In light of the plain language of the Contract, the court of appeals correctly concluded that the warranty of seaworthiness, as well as any other requirement imposed by the Vessel Plans and Specifications, was subsumed

within the definition of guarantee deficiency in the Contract. Appendix A at 70a-73a. The court of appeals was also correct in determining that the remedies provided by the Contract were applicable. Therefore, petitioners' remedy is the right to recover the cost of repair, but not consequential damages or damages for loss of the vessel.

III. *THE LIMITATIONS OF REMEDY WERE FREELY NEGOTIATED.*

One of the central themes underlying this Court's decision in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986), is that as to contracts between large economic entities, the parties should be left to the "benefit of their bargain." That is all that Avondale has sought in the present case and that is all that the court of appeals held.

With respect to the Contract, each party had a motive for allocating the risk as specified therein. Avondale had no prior experience in constructing ITB's and it only had limited control over the Oxy Producer's design. Moreover, the ITB concept had not been tested previously in transoceanic trade; prior ITB's were engaged exclusively in coastwise trade. Therefore, Avondale wanted to assume as little risk as possible. On the other hand, Occidental rejected a conventional vessel and sought the least expensive method of transporting its superphosphoric acid to the Soviet Union. In order to obtain a lower cost for the Oxy Producer, Occidental was willing to absorb a greater portion of the risk vis-a-vis Avondale. The court of appeals recognized this fact:

> In the instant case, Avondale argues that because the design for the Oxy Producer was relatively novel, it was willing to assume only the

> most limited liability for possible defects. The contract reflects this allocation of risks. Occidental agreed that in the event of a guarantee deficiency, Avondale would be liable only for the cost of repairing or replacing the deficiencies. It agreed that Avondale would not be liable for any damage to the vessel, its cargo, or its equipment, arising from such deficiency. We will not disturb the agreed-upon allocation of risks simply because the worst of those risks has materialized.

Appendix A at 83a.[4]

Although the Contract allocated considerable risk to Occidental, this does not mean that Occidental had to, or did, bear this risk by itself. This Court noted in *East River:*

> [W]hen a product injures itself, the commercial user stands to lose the value of the product, risks the displeasure of its customers who find that the product does not meet their needs, or, as in this case, experiences increased costs in performing a service. *Losses like these can be insured.*

476 U.S. 871-72 (emphasis added).

Occidental realized, as this Court did in *East River,* that its risks could be insured. It obtained insurance to cover these risks. The primary petitioners in the present case are the underwriters who insured Occidental. The fact

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[4] Quoting a case applying New York law, the court of appeals recognized that: "[t]he rule that the agreed upon risk should not be disturbed is particularly appropriate where, as here, the warranted item is a highly complex, and in some ways experimental piece of equipment." Appendix A at 82a, quoting from *American Electric Power v. Westinghouse Electric Corp.,* 418 F.Supp. 435, 459 (S.D.N.Y. 1976).

that a large commercial entity such as Occidental chose to allocate risk to its insurers rather than to Avondale was totally rational, and this allocation of risk should not be upset by the courts. Thus, the court of appeals was eminently correct in refusing to reallocate the risks among the parties.

IV. *THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE CONTRACT'S REMEDY DID NOT FAIL IN ITS ESSENTIAL PURPOSE.*

Relying on §2-719(2) of the Uniform Commercial Code ("U.C.C."), petitioners argue that the Contract's limited remedy failed in its essential purpose. Petitioners assert that because the sinking of the vessel precludes the possibility of repair, the remedy has failed in its essential purpose and therefore should be disregarded in favor of other remedies provided by the U.C.C.[5] Petitioners' argument does not withstand proper analysis.

The court of appeals recognized that "whether 'circumstances' have caused a remedy to fail depends on whether the contract anticipated and allocated the risk that the exclusive remedy would not cure all defects." Appendix A at 79a, 80a. If the Contract anticipated that the

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[5] Avondale disputes whether the U.C.C. is applicable in the present case. The court of appeals noted that it was not clear whether, under New York law, a vessel construction contract was to be considered a service contract to which the U.C.C. did not apply, or a sales contract to which the U.C.C. applied. *See* Appendix A at 28a n.12 and 75a. In view of this disagreement and uncertainty as to the applicability of the U.C.C., the court of appeals was correct in noting that "[i]t is not clear that parties should be made, simply by force of analogy, to 'accept the legal consequences' of making a contract subject to these particular code provisions." Appendix A at 75a n.53.

exclusive remedy would not cure all defects, §2-719(2) does not apply because that subsection is concerned "with the application of an arrangement to novel circumstances not contemplated by the parties." Appendix A at 80a n.54 (quoting 1 State of New York Law Review Commission, Study of the Uniform Commercial Code 584 (1983)). Thus, in order to determine whether the remedy has failed in its essential purpose, one must resolve the question posed by the court of appeals -- whether the Contract "anticipates that repairs may be impossible." Appendix A at 80a.

The court of appeals properly recognized that circumstances where repairs were impossible "were not beyond the contemplation of the parties." *Id.* at 81a. On this point, the court stated:

> The guarantee deficiency clause thoroughly recognizes the possibility that a deficiency could result in damage to the vessel and its cargo. The risk of such loss is allocated by the express terms of the contract to Occidental.

Id.

The risk of loss is allocated to Occidental by Article XVIII of the Contract, which excludes consequential damages, including damage to the vessel. Under New York law, such a limitation of consequential damages acts as an independent remedy limitation which remains applicable even if a repair or replacement remedy fails. *Computerized Radiological Services, Inc. v. Syntex Corp.*, 595 F.Supp. 1495, 1510 (E.D.N.Y. 1984), *aff'd in part and rev'd in part on other grounds*, 786 F.2d 72 (2d Cir. 1986); *Cayuga Harvester, Inc. v. Allis-Chalmers, Corp.*, 465 N.Y.S.2d 606 (N.Y. App. Div. 1983); *American Electric Power Co. v. Westinghouse Electric Corp.*, 418 F.Supp. 435, 457-58

(S.D.N.Y. 1976); *accord County Asphalt, Inc. v. Lewis Welding & Engineering Corp.*, 323 F.Supp. 1300, 1308-09 (S.D.N.Y. 1970), *aff'd*, 444 F.2d 372 (2d Cir.), *cert. denied*, 404 U.S. 939 (1971) (applying New York and Ohio law). In upholding the independent exclusion of consequential damages, the court of appeals noted that consequential damages in the present case did not result from Avondale's failure or refusal to repair the guarantee deficiencies. Rather, the consequential damages preceded full repair opportunities and rendered actual repair impossible. Appendix A at 78a.

A comparison of the provisions of Articles XI and XVIII further demonstrates that the parties intended to allocate to Occidental the risk of loss of the vessel after delivery. Article XI expressly imposes on Avondale the *pre-delivery risk of loss* of the vessel, while Article XVIII governing guarantee deficiencies expressly *excludes* liability for damage to the vessel.

Two final points are important. First, this is not a case where the remedy of "repair or replacement" fails because the manufacturer refused to make repairs, or made repeated unsuccessful repair attempts. Rather, until the time the tug sank, repairs were possible and there is no evidence that repairs would have been unsuccessful. Second, even if actual repair is no longer possible, the remedy has not failed. As the court of appeals noted, "[t]he Construction Contract would allow recovery of the *cost* of repair." Appendix A at 79a (emphasis in the original). In fact, as the court of appeals recognized, the value or cost of repairs is all that petitioners could have recovered had vessel survived, regardless of the severity of damages. Appendix A at 81a. Therefore, petitioners are left with a remedy that is consistent with risks which the parties contemplated and allocated. In light of what the parties agreed

upon, the remedy is not inadequate and did not fail in its essential purpose.

CONCLUSION

No aspect of the issues relating to Avondale and Ogden merit this Court's review. The questions presented involve the interpretation of a particular contract in light of New York law. Further, and more importantly, the court of appeals was correct in its resolution of these issues.

Whether expressed in terms of "failure to mate the tug and barge properly" or "failure to provide a seaworthy vessel," the cause of the tug's sinking, as found by the court of appeals, fits within the Contract's definition of a "guarantee deficiency." Thus, it is subject to the Contract's limitations of remedies and liabilities.

The Contract's limited remedy did not fail in its essential purpose. Petitioners can still recover the cost of repairs. The Contract's exclusion of consequential damages, including damage to the vessel, operates as an independent provision which allocated the risk of the loss of the vessel to Occidental. Thus, the parties contemplated and allocated the risks. Although some of the greatest risks materialized, this does not justify reallocating risks freely allocated between two large commercial entities.

For the foregoing reasons, Respondents respectfully submit that the Petitions for Certiorari in Docket Nos. 88-2049 and 88-2052 should be denied.

Respectfully submitted,

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APPENDIX: Listing of Parent, Subsidiary and Affiliate Companies of Avondale Shipyards, Inc. and Ogden Corporation in Accordance with Supreme Court Rule 28.1.

Allen & Company

Avondale Industries, Inc.

Avondale Shipyards, Inc.

International Terminal Operating Co., Inc.

Ogden Bulk Systems Company, Inc.

Ogden Catering of Texas, Inc.

Ogden Corporation

Ogden Projects, Inc.

Rototest Laboratories, Inc.